THE NATIONAL CITY BANK OF NEW YORK

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Economic Conditions
Governmental Finance
United States Securities

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General Business Conditions

THE rise in security and commodity prices over the past few weeks has brought a new spirit of encouragement and hope to business, both in this country and in Europe, where the American markets have been considered to reflect most truly the course of the depression, and hence most likely to give the first sign of a turn. The long period of strain and anxiety had seemed almost to have no end, and had developed in many quarters a growth of pessimism of the gravest kind, reaching its worst in fears that the economic system itself would not survive. But the extreme fears entertained during the Spring have not been realized, and now, in decisive terms, the markets show recovery from the state of panic. The anxieties caused by depreciating values are lightened, and once more people believe that business will get out of the depression, and that with cooperation and orderly adjustment the economic organization will function normally again. This is a very heartening change in a quarter where improvement was essential; for of course it was necessary that people should regain their belief in the recuperative powers of the economic system before there could be the will to spend and invest necessary to recovery.

Moreover, the breadth of the price advances, embracing all markets, indicates that the cause was a general one, believed to affect the entire business situation. The pessimists had questioned chiefly the ability of the United States to remain upon the gold standard, and had doubted the determination of the Congress to keep the country upon it. Now the panicky nature of these fears is revealed, and the country is gaining gold in substantial amounts, the inward flow resulting in part from purchases of American securities by foreigners whose confidence in the dollar has been restored. This repeats the lesson of every past depression, namely, that the country has needed not more money, as so many have urged, but more confidence in the money it has. The gold movement is promoting confidence in the credit situation.

There are other developments laying the foundation for the renewal of hope. Senator Borah's position indicates that there will be strong leadership for appropriate action upon the war debts when the expected applications for revision are received in the Autumn. The Presidential campaign is proceeding along the conservative lines of the party platforms, which declare against monetary legislation of unsound character. The great operation of refunding the £2,000,000,000 British 5 per cent war loan into a 3½ per cent obligation has had a remarkable success, with 88 per cent converted up to July 31; it has improved sentiment throughout Europe, and has influenced interest rates and therefore the prices of securities everywhere.

These developments, promising over the long range, give reason for the improvement. They do not imply that the world is ready for a rapid recovery to normal conditions, in view of the reduced purchasing power everywhere, and the almost insurmountable obstructions in the way of world trade; or that further periods of discouragement and uncertainty will not be encountered. But we do not think that business men are disposed to ask too much at once of the situation. They will be satisfied with a slow rate of recovery if there is indubitable evidence over the next few months that the decline is at last over and the turn begun.

The Rise in the Markets

The rise of about 100 per cent in common stocks over the July low exceeds any previous rise during the depression, or any of the rallies that have terminated bear markets in the past, by a wide margin; and perhaps may have moved too swiftly in view of the absence of supporting improvement in earnings. However, it is natural that a recovery from extreme panic should outrun business gains. The advance affects more people than ever before, since the number of shareholders in American corporations is now far greater than ever before. According to recent compilations the number of stockholders in the larger corporations has risen 40 per cent in the past two

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years. This is an impressive indication of the increasing number of people who feel richer or poorer according to the ups and downs of the market, and who therefore are heartened by the advance.

In the bond market the rise has been vigorous and sustained, with the Dow-Jones average of corporate bonds up about 25 per cent. This advance is not only a cause for general encouragement in that bond prices give the best index of capital seeking employment, but it also relaxes the pressure on the credit-granting institutions, since the decline in bonds has been a principal factor in their difficulties. Now the bond account can be marked up again, with substantial relief to the banking system.

Another and very cheering factor is the continuance on a broad scale of the advance in commodity prices, a development which had not accompanied any previous rally in the stock market during the depression. The gains have now spread to nearly all the farm products and staple raw materials. Cotton is up sensationally, more than 4 cents from the low, wheat has been firmer, beef cattle have risen further, and hogs while below the July top are steady and return a profit on feeding operations. Wool markets have been active at higher prices, and butter and eggs have had good advances also. These are the chief sources of cash farm income, and accordingly the farmer will receive more for his production than seemed possible a few months ago.

This is a start toward correcting the most stubborn condition prolonging the depression, which is the unbalanced relationships between prices. From the beginning of the fall of prices the farmers and other producers of raw materials and foodstuffs have steadily lost in purchasing power in terms of the goods they buy, and this single fact has been greatly responsible for the falling off in trade and manufacturing activity, for unemployment and loss of industrial power, and thus for the steady pressure on prices generally. Now the spread is narrowing somewhat, with finished goods at wholesale lagging behind the rise in primary products, and retail prices of manufactured articles and the cost of living still declining, according to the latest indexes. This is precisely the condition that will promote recovery.

However, a rise in commodity prices sufficient to close the price spread is not anticipated, and it will be necessary to keep on closing it through reduction of costs if recovery is not to be gravely delayed. It would be a misfortune from which everyone would soon suffer if the better feeling should lead to relaxation of efforts in this direction. The country is lacking purchasing power, and the source of purchasing power is the maintenance of price relationships so that producers can exchange their products upon an equitable basis. The lack of balance between wages, transportation costs, building costs and costs in many industries on the one hand, and the returns to the farmer and to farm labor on the other, is now the most serious maladjustment in the business situation. It needs to be remedied to give back to the various groups in the population the purchasing power they have lost.

Trade and Industrial Conditions

Despite the improved markets, there has been little inclination to look for gains in industrial activity until Fall, when cooler weather and the crop movement come to the aid of business; and it is well that expectations have been restrained, for otherwise the ruling sentiment now would be one of disappointment. There has been a very vigorous recovery in textiles and related lines entering into the seasonal wholesale trade, but otherwise evidence of increased business has been scattered and unimpressive. In the heavy industries further declines have occurred, with steel mill operations running most of the month at 14 per cent and orders no larger, automobile production reduced to the lowest figures of the year, and daily average awards of building contracts to the 22nd of the month 12.3 per cent below the July average, and 49.6 per cent below last year.

While making a steady showing, the general indexes of business activity reveal little or no gain, either actually or in comparison with last year. Latest figures on the volume of checks cashed, freight cars loaded, electric power consumed and commercial bank loans show few changes other than seasonal, and are below 1931 by about the same margin as earlier in the Summer. Pick-up in rural trade is not evident in the latest sales figures of Sears, Roebuck & Co., which for the four weeks ended August 13 were 27.4 per cent under last year; this is a less favorable showing than earlier in the year.

Against this evidence of continued sluggishness is the broad improvement in the textiles. The buying has covered all lines of goods, and has reached a volume giving the mills for the first time since last Winter a substantial backlog of unfilled orders. Price advances in all the textile materials have been sharp and the markets buoyant, and markups giving tangible evidence of the change for the better have followed in a variety of goods.

A report of the textile markets in the Journal of Commerce gives the following analysis of the improvement:

> Much of it is of a seasonal character, impelled by the necessities of storekeepers for more goods on which to do their Fall business. A substantial part of it results from the excessively low inventories in

many wholesale and cutting-up channels that must be replenished quickly if their directors are to remain in business for the Fall season. No small portion of it has come along in consequence of the growing confidence in agricultural sections, where an abundant corn crop is assured and where live stock prices have been rising. * * * The general influences of a financial or speculative character that have helped other lines have helped textiles in their recovery. Underlying the whole situation is the fact that prices for raw materials and made-up textiles have manifestly hit the low points, for a time at least, and users and traders alike are gaining more confidence in values that have gone a very long way in concessions to low buying power.

This is a fair statement of the favorable side of the general business situation. It stresses the psychological factor of the relief from extreme pessimism, and the tangible facts of deferred needs and the price firmness. These are influences affecting Fall prospects for all lines, but the scarcity of purchasing power upon which we have already commented is to be considered.

Efforts to Promote Recovery

The lack of improvement in the general business indexes has inspired doubt as to the significance of the price advances, and this being a Presidential year some observers have made the deduction that the rise has been "engineered" for the advantage of the party in power, to further the interests of its candidates by promoting or giving the appearance of business recovery. Of course, business recovery would be in the interest of the Republicans, but it would also be in the interest of everyone else. It should be unnecessary to say, after the terrible distress of the past year, that all possible leadership and cooperation in promoting recovery would be given irrespective of the campaign, and by men of both parties, as in fact is the case. The meeting in Washington August 26 was of this character.

As to the buying in the markets, if any group had power to bring about recovery or to stimulate improvement by market action they would not have waited to exercise it on behalf of political interests, but would have used it long since to avert their own losses. The fact is, of course, that the buying which advanced the markets has come from the plainest of motives, i.e., to make money, and was done because the buyers, impressed by the constructive developments, and believing that prices had overdiscounted anything likely to befall, considered their purchases cheap. They may or may not be correct, but there is no occasion for any other explanation.

A practical disproof of this belief is the breadth of the rise in all markets, the volume of trading, and the fact that it is worldwide. The following table gives the percentage of increase over the lows in prices of stocks, bonds and commodities in the four principal markets of the world, according to index numbers which, if not precisely comparable, will show the trend. Prices in the United States have recovered most strongly, but they had previously declined most severely. German prices have advanced least, reflecting the special uncertainties of her position. In Great Britain and France the rise in stock prices has been substantial:

Percent Change in Market Prices
(Fisher's Indexes)

	Stocks	Bonds	Commodities
New York	+76.0	+17.4	+4.4
London	+26.0	+11.2	+6.1
Paris	+40.1	+ 3.0	+3.0
Berlin	+13.8	+ 6.4	+ .1

The Talk of Inflation

Another interpretation put upon the price rise, again with an eye upon the sluggishness of business, is that it is an inflationary movement caused by forcing Government credit into the price structure. This has reference to the operations of the Reconstruction Finance Corporation and to the Federal Reserve Bank purchases of Government securities and their use as backing for the currency under the Glass-Steagall Act.

Either as a reason for considering the rise unwarranted, or as a motive for expecting it to carry to greatly higher levels, this interpretation has little to commend it. The country has badly needed a revival of confidence and a cessation of the disastrous liquidation. If the operations in support of the credit situation have been instrumental in bringing this about it is no more than they were intended to do, and likewise perhaps all they could be expected to do.

The idea that the operations cited were inflationary in intent and character is not a new one and has been discussed in these Letters on several occasions. We are of the opinion that the term "inflation" does not apply to the creation of Government credit to replace private credit destroyed through panic, or to the creation of Reserve Bank credit to replenish bank reserves which had been depleted by people burying currency in the ground. Under these conditions there was no addition to the supply of credit in use, and in fact the volume of bank loans and investments has continued to decline to this day.

Now there is more confidence and rising markets, but no more demand for credit. The Government is not making use of these measures to speculate in the markets, nor is it operating the printing press to pay its bills. Moreover, the Reserve Bank credit put out to replace the currency and gold withdrawals is being retired, and undoubtedly will be reduced further as the currency and gold come back.

It must be expected that an increase in the volume of credit in use will occur only through

the use of credit by business, and that credit expansion therefore cannot take place without some measure of business recovery. The history of the depression reveals no method of forcing credit into an unwilling business situation.

Earlier paragraphs in this Letter have suggested that the credit factor will not be paramount in determining the permanence of the recovery. Credit conditions are improved and more favorable to recovery than they were, and this is a very necessary gain, but the controlling factor in bringing business back will be the extent to which there is cooperation in restoring the equilibrium among the various elements in the economic system, in reviving purchasing power, and in dealing with the difficult political and fiscal problems which confront the governments of the world. These will ultimately give the answer whether recovery is finally under way, and if so how rapidly it will move.

Commodities Finance Corporation

Probably the long discussion preceding the organization of the $50,000,000 Commodities Finance Corporation gave circulation to the idea that an artificial stimulus was to be applied to the markets. If so, the plan of organization of the Corporation should remove the misapprehension. The Corporation will not make purchases on its own account nor make loans upon other than a sound banking basis. It is not its purpose to encourage unnecessary buying. It is in fact an adjunct of the banking system, organized to make the resources of the New York banks available in centers where manufacturers may be lacking in facilities to finance purchases of commodities, due to failure or strained conditions among local banks. The funds of the Corporation will consist of a nominal capital, and subscriptions to its notes by members of the New York Clearing House Association and other New York City banks, and its operations will be conducted through two subsidiaries, one to undertake an acceptance business, and the other to carry on a finance business. With the initiative left in the hands of manufacturers, whose buying will naturally be determined by strictly business considerations, the operations of the Corporation will be wholly natural and beneficial.

There is no connection between the organization of the Corporation and the advance in commodity prices unless it is one of sentiment. The rise is an inevitable rebound from extreme low levels, derived in some cases chiefly from an increase in demand, as in wool, silk and hides, and in others chiefly from a reduction in the supply, as in cotton and cottonseed oil, cattle, coffee and sugar.

Farm Markets and Prospects

The most important development in the farm situation is the rise of cotton prices to above 9 cents in New York, the highest in more than a year. The Government's crop estimate as of August 1 presented a bullish surprise to the trade, indicating a production of 11,306,000 bales, about one million under the general expectation. The report referred to the prospect of heavier boll weevil damage than in some years, and to the small number and size of the bolls which is a consequence of the insufficient use of fertilizer and the exhaustion of the soil by last year's bumper crop. During August the weather has continued showery, which promotes weevil damage, and belief that the estimate due on September 8 will be still smaller has combined with improvement in the cotton goods markets to advance the price.

There is no prospect of scarcity of cotton, for the carryover of American cotton into this season, about 13¼ million bales, was more than last year's consumption, which was 12½ million. But by reason of the smaller crop the total supply this year is smaller than last, and the demonstration that the law of supply and demand is still operating has cheered the South. Of course, there is an offset to the higher price in that the farmer will have less to sell, the yield per acre being 150 pounds this year against 200 last. However, the crop has been made very cheaply, with smaller cash expenditure than in any year since the '90s. If the price holds during the marketing season the sections where the crop is not a failure will have money for living expense, to pay taxes and interest, and perhaps also to pay off debts. This is an improvement over the past two years, for which the credit belongs to the economies practiced.

Farm wage rates over the United States averaged in July 13 per cent less than in the five years before the war. This is a demonstration of the effects of the lack of balance in the economic structure. If some elements are able to resist adjustment the pressure elsewhere is correspondingly increased, and somewhere in the structure a place must be found that will give. The wages of farm labor have given way in far greater degree than other wages, and in consequence farm laborers are unable to buy the products of the labor in the industries.

The last general crop report showed yields per acre below average for most crops, and in addition to cotton the wheat and tobacco crops are greatly reduced. On the other hand, the feed grains promise nearly average yields on increased acreage, and the total tonnage is expected to be about equal to 1925 and 1928 and more than in any other year since 1920.

The corn crop has improved during August This is a favorable situation for the livestock feeders and the dairymen.

The wheat situation has shown little change. The crops in the exporting countries of the Northern Hemisphere except Canada are smaller, and Russia will be less a factor than earlier supposed, to judge by the unfavorable harvest news and the lack of offerings. But importing countries have larger crops, and the Southern Hemisphere has planted a larger acreage, the latest estimates giving Argentina 11 per cent and Australia a still greater increase.

Sponsors of the movement in the Northwest to hold wheat off the market until the price reaches a dollar a bushel should take warning that if they do not wish to produce and sell below that price others will do so. If the wheat growers of the Southern Hemisphere will increase their acreage at the prices now prevailing it may be imagined what they would do if the world price were held up for them in such a manner.

The "farm strike" in Iowa and elsewhere that the newspapers are describing at such length advertises the inequalities of the farmer's position, but as an effort at self-help it is misdirected. Of course, it is even less possible to accomplish anything in this way than it was through the operations of the Federal Farm Board, supplied with hundreds of millions of Government funds. The chief sufferers from the strike will be the strikers themselves, most of all those who have destroyed products or allowed perishables to go to waste in the foolish gamble that this would induce price improvement.

Money and Banking

The banking situation continues to grow steadily easier, and the supplies of funds seeking investment steadily larger. Under the influence of returning gold and currency, bank reserves have risen rapidly to the point where the excess above legal requirements is the largest since May, when the Federal Reserve campaign to promote credit expansion was at its height. At that time the efforts of the central bank authorities failed to accomplish their purpose, largely because of fear which kept the available credit from being put to use. Given a revival of confidence, it seems unlikely that the large supplies of funds will fail to find reflection in an upward trend of bank credit.

During the first twenty-seven days of August gold imports and releases from earmarking added $90,500,000 to monetary stocks, making the net gain $157,000,000 since the turn in the tide of the gold movement in June. At the same time the hoarding of currency throughout the country has given evidence of being on the wane, the figures as to money in circulation showing a reduction of $51,000,000 in the five weeks ended August 24 compared with an increase of $186,000,000 a year ago.

Both movements, of course, tend to ease the position of the banks, the consolidated returns of which show a reduction in borrowing from the Reserve banks to the lowest point of the year and an increase of reserves in the manner described.

Member Bank Credit Higher

At the member banks, the volume of credit has increased, due, however, to bank subscriptions to new Treasury issues. There is not yet evidence of any enlarged demand for credit for general business purposes. Aside from the investments in Treasury securities, bank loans and investments have shown further declines, loans touching new low points for the year.

A particularly interesting feature of the decline of loans on collateral and of bank holdings of securities other than United States Governments has been its occurrence in the face of the marked rise in the security markets. For this the explanation appears to be that individual investors throughout the country have been buying securities for cash the proceeds of which have gone to reduce the loans of those who have been carrying securities on margin. This type of buying strengthens the technical position of the market, and brings nearer the day when buyers will be willing to employ credit in the purchase of securities. In this connection it is of interest to note that loans of New York banks to brokers showed a slight increase during the month.

The Bond Market

The upward surge of the bond market has been commented upon as one of the most encouraging features of the situation, spreading confidence in further improvement and bolstering up the financial structure at its weakest points. Beginning early in July the Dow Jones bond average advanced 12½ points almost without a break, wiping out the disastrous losses of the Spring and recovering to the levels of last November. Semi-speculative and speculative bonds experienced sensational advances, many issues doubling in value, with others reaching levels several times their panic lows. Late in the month the bond market ran into some profit-taking—to be expected after so rapid an advance.

Already the rise which has taken place has done wonders in reconstituting institutional portfolios, while the commencement of the breaking down of the barriers against new is-

sues has been indicated by the successful flotation of a number of high grade public utility issues, including within the past month $18,000,000 of bonds for the Commonwealth Edison Co., and $20,000,000 each for the Peoples Gas Light & Coke Co., and the Public Service Company of Northern Illinois. Unquestionably, the developments thus indicated are of immense importance in the situation.

We have already referred to the rise of bond prices as unaccompanied by evidence of increased buying by the commercial banks of the country. Apparently, the market has been undergoing a psychological change, induced by the failure of exaggerated fears to be realized, the re-establishment of confidence in the monetary system, and such hopeful symptoms as the rise of commodity prices and accumulation of funds. Gold is flowing into the country, currency hoarding is decreasing and bank reserves are increasing. It is recognized that these are tendencies favorable to higher bond prices.

Rail Bonds Leaders

While the strength of the bond market has been shared by all departments, the largest gains have been in the cheaper rails which suffered most during the decline. These bonds have been helped by the revived hopes of a traffic pick-up; the recent action of the Interstate Commerce Commission in approving the consolidation plans for Eastern railroads; talk of a further wage reduction; and the announcement by Mr. E. G. Buckland, head of the Railroad Credit Corporation, that he saw no reason for any more major railroad receiverships in 1932. During the past month the Reconstruction Finance Corporation approved $61,000,000 additional loans to railroads for the purpose of meeting maturities and other necessary obligations, bringing the total of such advances to $297,000,000.

The market for United States Government obligations continued strong, despite the withdrawal of the Federal Reserve Banks from the market as purchasers. Most of the Liberty and Treasury bonds reached new high levels for the year, while new 90-day Treasury bills sold on an average basis ranging from 0.53 to 0.32 per cent, indicating that capital has not yet got very far in overcoming its reluctance to stray beyond the safest and most liquid investments. The announcement by the Attorney General of the United States that national bank notes, issued on the backing of Treasury bonds bearing 3⅜ per cent interest or less under terms of the new Home Loan Bank Act, would have to be retired in three years from the effective date of the Act caused some reaction in the bonds concerned, following their previous strong rise.

Municipal Bonds and Expenditures

The steady absorption of municipals by investors seeking tax exemption, together with a scarcity of available offerings due to the general retrenchment of public borrowing, has created an unusually strong situation in the municipal market where supplies of bonds in the hands of dealers are estimated at around $25,000,000, compared with $75,000,000 to $100,000,000 in normal times. Despite the probability of some borrowing for public relief purposes, prospects point to a continuing scarcity of offerings, due both to the slowing down of public improvements and because municipal bonds, being serials for the most part, do not as a rule call for the large refunding operations which tend to sustain activities in the corporate market during periods of low interest rates and slack demands for new capital. Prices in general continue very firm, with the demand, however, remaining highly discriminating, as investors are not hesitating to pass up offerings which fail to show conclusively that the borrower's financial affairs are in good order.

There is no doubt that the campaign for reducing the excessive cost of government is making rapid headway throughout the country. The increased burden of taxation on reduced incomes, coupled with the tightened standards of the investment market, is accomplishing what all the arguments and warnings of the past few years have failed to do.

Within the past month the National City Company has asked its branch offices in different parts of the country to secure reports on the progress of economy in states and representative counties and cities within their jurisdiction. Up to the time of our going to press reports had been received from twenty-one states, eleven counties, and eighty-eight cities. Limitations of space forbid any lengthy discussion of these reports, but it can be said that the facts presented give a striking picture of the growing proportions of the economy movement. By far the greatest majority of the reports indicate balanced budgets—in most cases on a lower level of expenditures than a year ago. There is a distinct trend towards a lowering of salaries and wages, the usual cut being 10 per cent. In many cases where the law does not permit compulsory reductions, cuts have been taken voluntarily, while in some instances resort has been had to special arrangements such as extra vacations of a week to a month without pay. Most communities report the abandonment or postponement of public works and improvements not urgently needed.

A danger, of course, in all such economy drives lies in that kind of indiscriminate paring down of expenses which impairs efficiency,

checks essential development and in one way or another increases rather than decreases waste. A serious responsibility rests with the public authorities to see that economy programs are wisely directed so that real saving can be accomplished. The country cannot afford to overlook the fact that the states and municipalities face a difficult problem in providing for unemployment relief during the Winter months. A carrying forward of soundly conceived essential public improvements would be helpful in solving this problem and ought to be done in times like the present when the labor and materials can be had on favorable terms. Such added obligations, however, cannot be incurred by the overburdened communities without economies in other directions. Every saving, therefore, of unneeded expense not only implies relief from oppressive taxation, but opens the way to alleviating in some degree at least the distressing conditions of unemployment. The Reconstruction Finance Corporation can be a powerful force towards accomplishing this end by insisting upon the proper retrenchment on the part of applicants for credit.

Undoubtedly, much can be done in the way of reorganizing local government, including consolidation of counties, road districts, and the like, so as to avoid unnecessary duplication of government functions. An example of an intelligent attack upon the problem of governmental costs is the investigation for the State of New Jersey recently undertaken by Princeton University at the request of Governor Moore.

The Ottawa Conference

The recent Economic Conference of the British Commonwealth of Nations, at Ottawa, failed to realize the hopes of its promoters, but rather vindicated the judgment of the orthodox British economists, who always have held that the moral and political unity of the Empire would be more surely maintained by a policy allowing Great Britain and her scattered dominions to manage their business affairs independently, and with sole reference to the particular circumstances of each, than to attempt to have a common and exclusive economic policy.

Two great changes from the pre-war situation no doubt have been largely responsible for the departure now made. One of these changes was in the British constitution, definitely establishing the status of the dominions as independent nations, and the other was the change in the foreign trade policy of Great Britain from the principle of free trade to that of protection and managed trade relations. The dominions had long claimed that their products should have some advantage over alien products in the markets of Great Britain, but the other trade relations of the mother country, and her own necessities for cheap food and raw materials, seemed to make such advantage impossible. The war opened a new chapter in imperial history. The dominions gave a wonderful exhibition of fidelity in coming through the seven seas to the support of the mother land, and when the war was over their claims to consideration were not easily denied. Furthermore, Britain had determined to risk a new trade policy with the world. A strong party had developed at home upon the rallying cry that Free Trade had meant nothing but Free Imports and that the home market had become a dumping ground for the world, while foreign markets were closed to British products. In the disturbed state of world trade there seemed to be a good case for the argument that Britishers everywhere should stand together.

It is probable that the example of the United States, with its growth in population, productive power and wealth under the protective policy, has been a stimulus to the idea of a common policy of protection for the British Empire, but any analogy thus drawn is delusive. The United States is one country, peculiarly suited by reason of its natural resources to secure a rapid increase of population, and the area of free trade within its boundaries—far greater than existed anywhere else—has been even more important in its prosperity than the regulation of foreign trade. The new British Commonwealth is not one nation, its component parts are widely separated, their interests are distinct, and it does not follow because they have the ties of a common ancestry, a common language and literature, that they can trade with each other more advantageously than with other peoples. They were warned by wise counselors of their own that the ties of sentiment are stronger in themselves than if an attempt is made to use them for profit. There is a very old saying, which probably came down to us from the British, to the effect that business relations within a family are dangerous to harmony.

The Basis for Sound Trade

The only true basis for business is reciprocity of interests. In the introductory talk and work of the Ottawa Conference it was emphasized that a spirit of reciprocity must prevail, and that sacrifices must be made in detail for larger gains in the aggregate results. As the Conference advanced, reports of proceedings indicated that the proposals were generally based upon the principle of reciprocity in sacrifices. Thus, Great Britain was asked to pay more for food produced within the Empire than the same would cost outside, and seemed to be willing to do so provided sufficient reci-

procity was given by purchases in Great Britain of manufactures which the food-producers for various reasons would rather buy elsewhere. It would seem to be obvious that the more of such reciprocity there might be, the poorer all parties to it would become, but this is the course that bargaining must follow in order to divert trade from its more natural channels.

We hasten to say that nothing more absurd was done or proposed than what the United States has done in fostering the development of a sugar industry on the other side of the world—in the Philippine Islands—by the ruin of the sugar industry of Cuba, this country's natural and cheapest source of supply; or anything more absurd than our policy in building a high fence against Canadian products. The truth is that, except as a safeguard against deprivation in the event of war—which our Philippine sugar supply does not accomplish—there is no good reason why trade should not follow the lines of greatest mutual advantage, regardless of national boundaries.

The Conference brought the new nations and the mother country face to face with the same old conflict of interests, or opinion, which had existed before the war. Great Britain has a highly industrialized population of 45,000,000, with an area quite incapable of supplying the food required by her people or the raw materials required by their industries. It is imperative that she shall export products and services in order that she may pay for these necessary imports. On the other hand, the new nations, not including India, have about 30,000,000 population, great areas of territory, varied and abundant resources, and are ambitious for growth and diversified development. They are strong for protection as a policy for making themselves as nearly self-sufficient as possible. They do not want to import any British manufactures which they can produce for themselves, and they even plan to become exporters of manufactures. They value the British market for their foodstuffs and crude products, but do not want to simply play the part of exchanging such products for manufactured goods.

The Wheat Preference

Canadian exports of wheat and flour in the five years 1926-30 averaged 31 per cent of her total exports, and Mr. Bennett, the Canadian Premier, set as one of his principal objectives to obtain a substantial preference for Empire wheat in the British market. The British grain trade, including the Grain Pool of the farm cooperatives, has taken the position that a preference would be of no value, because the total of Empire surplus is greater than the English market can absorb and sales in outside markets would make it necessary to take the same price for the portion marketed in England. This view is confirmed by a recent British official publication (*), which calculates Empire production in recent years about 3,000,000 tons in excess of Empire consumption, a marked change from the pre-war position. Possibly for this reason, the British delegation assented to a duty of 6 cents per bushel on foreign wheat, with Empire wheat free, and also to a preference upon copper, lead, and zinc, as to each of which similar conditions exist.

The agreement also contains the following paragraph:

> Article 4. It is agreed that the duty on either wheat in grain, copper, zinc or lead as provided in this agreement may be removed if at any time empire producers of wheat in grain, copper, zinc and lead, respectively, are unable or unwilling to offer these commodities on first sale in the United Kingdom at prices not exceeding the world prices and in quantities sufficient to supply the requirements of the United Kingdom consumers.

It is not clear whether the term "world prices" as used in this paragraph has the usual meaning, i.e., prices in the principal world markets free of duties, or the prices of foreign products in the British market, duty paid. It remains to be seen how Empire producers can get more than world prices (in the usual sense) without making British consumers pay more; also what the reaction of these bargains will be upon British costs of living and Britain's trade with other countries.

In general, Empire products are placed on Great Britain's free list, and the Conference agreement calls for the imposition of certain duties upon imports from without. The duty upon butter will be 15 shillings per cwt., upon cheese 15 per cent ad valorem, eggs, 1 shilling per great hundred. These duties will stimulate home as well as Empire production and in time may affect importations from Denmark and other countries of the Continent. No definite terms for the regulation of foreign meat importations were fixed, but the promise is made that something will be done to favor Empire producers. Australia is particularly interested in a preference upon meat, and Argentina is the competing foreign country. The situation is complicated by the large British investments in Argentina and in the meat trades.

Provision Against Dumping

The agreement contains a provision, understood to be aimed particularly at Russia, whereby commodities whose competition by means of government support seems likely to "frustrate the preference granted to Empire products," will be excluded from Empire markets. Apparently this would apply to any products which the United States might ex-

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(*) A summary of Figures of Production and Trade Relating to Grain Crops, Empire Marketing Board, London, 1932.

port under any of the "equalization fee" or "debenture" schemes that have been before Congress in recent years.

From our viewpoint it is something to regret that the Conference did not yield results more satisfactory to the participants. It may be said to have reflected the state of disorder existing generally in international trade. The British peoples are as hard-headed, practical and intelligent as any in the world, and if they cannot find a broader basis than this for trade among themselves there does not appear to be much reason for expecting an improvement in trade relations elsewhere in the near future.

The Great Inflation and Its Results

General Jan Smuts, statesman of the Union of South Africa, has been quoted as saying that the quantity of gold in the world always has been insufficient to support the credit structure. It is strange that the statement should come from a person so prominently identified with a country which alone has produced more gold in the last forty years than had been produced by all countries together in the previous history of the world. He has been familiar with this outpouring, but believes that the volume of the world's business has increased more rapidly.

The General is a victim of the illusion which inflation always creates, i.e., the illusion that money is becoming scarce when in fact the supply is increasing so rapidly that the value is depreciating at a still higher rate. Under inflation the loss of purchasing power over commodities more than nullifies the increase of quantity. The Germans are the most thoroughly disillusioned people in the world regarding the advantages that seem to come from a rapidly increasing money supply.

It is generally recognized now that inflation did not begin with the war, but that the period 1900-1914 was one of continuing inflation, although the increasing volume of credit was amply supported by increasing reserves of gold. The term "inflation" properly applies not only to a state of money, credit and prices arising from excessive issues of paper money, but arising from any increase in the supply of money and bank credit which outruns the physical increase in the volume of production and trade, thus forcing a rise of prices. Inflation may be caused by an increasing supply of metallic money as well as by excessive supplies of paper money, although it is obvious that there is less danger from unrestricted coinage of gold than from unrestricted printing of paper money.

The production of gold in the world passed the $300,000,000 mark for the first time in 1899, fell back to $254,000,000 in 1900 on account of the Boer War, but thereafter rose steadily until it reached $470,000,000 in 1915. These increasing supplies were distributed over the world through international dealings in business and finance, finding lodgment in bank reserves or entering into circulation as coin. The following table gives the principal stocks of monetary gold at the end of December, 1900 and 1913 and the end of June, 1932. The figures for 1900 are from the Report of the Director of the Mint, those for 1913 and 1932 are from the Federal Reserve Bulletin:

Gold Reserves of Central Banks and Governments
(In millions of dollars)

	1900 Dec. 31	1913 Dec. 31	1932 June
United States	511	1,290	3,610†
United Kingdom	139	165	663
France	451	679	3,218
Russia	365	872	349
Germany	119	279	193
Italy	78	265	298
Austria-Hungary	186	251	87*
Belgium	21	48	357
Netherlands	24	61	394
Switzerland	19	33	503
Sweden	10	27	65
Norway	7	12	40
Spain	68	92	435
Argentina	—	256	249
Japan	33	65	214
15 (17) Countries	2,031	4,395	10,670
30 Other Countries	....	588	776
45 (47) Countries	...	4,983	11,446

*Austria, Czechoslovakia, Hungary.
†End of August, 1932.

Figures for 1900 are available only for 15 countries as given, but these include all important stocks at that time, and they still hold the principal stocks.

It will be seen that the increase in gold stocks was vastly greater from 1913 to 1932 than from 1900 to 1913. This is explained, not by increased production after 1913, for production fell off after 1915 on account of the war, but by the fact that prior to the war the production entered largely into circulation as coin, while during and since the war coin has not been used in circulation and the coins previously in circulation have been to a great extent gathered into bank reserves. The figures indicate the enormous economy in the use of gold effected by this change in practice, and it is to be considered also that each dollar of gold in bank reserves will support several dollars of paper money in circulation and a much larger amount of deposit credits in circulation by means of bank checks.

The First Period

Excepting the United States, Russia shows the largest actual gain from 1900 to 1913, which is attributable to a reorganization of its monetary system on a gold basis and in part presumably to political policy. France shows a large gain, which is characteristic of the French

liking for large reserves; moreover, prior to 1900 the Bank of France held important reserves of silver. The Bank of England's gain in the first period was relatively small, especially when it is considered that the Transvaal gold came to London for sale, but it always has been characteristic of the Bank of England to operate upon comparatively low reserves, a policy made possible by the country's creditor position in world affairs. Germany's gain corresponded to her growing importance in world trade. Austria-Hungary, Italy and Japan very much strengthened their positions on the gold basis. A prominent feature of this period was the reorganization of monetary and banking systems with substantial additions to reserves. In this sense it may be said that the increased gold production was partially utilized in simply strengthening the banking organization.

The United States made the largest gain, which is partially accounted for by the fact that practically none of its increase went into circulation, but all into reserves. It was a period of great economic activity and development in this country, also of banking expansion. The number of banks increased from 10,382 in 1900 to 25,993 in 1913 and their total resources from $10,785,900,000 to $25,712,164,000.

The Gold Inflation

This period, 1900-1913, was one of rapid economic progress, which was stimulated by the increasing gold reserves and the rising tendency of prices. However, signs of credit inflation were very marked, and the period was characterized by great instability. Notwithstanding the heavy influx of gold, and great expansion of credit, the supplies of credit were rapidly absorbed and credit stringency was an almost chronic condition. There were more or less violent industrial reactions, with disturbances in the money and stock markets in 1900-1901, 1903-1904, 1907-1908, 1911-1912. That of 1907-1908 began with a nation-wide banking panic in which nearly all banks in the country suspended cash payments, and the effects of which were worldwide. Industry did not fully recover from this shock for several years. No more conclusive proof of the unhealthful influence of monetary inflation should be needed than is supplied by this extraordinary period, but if any more proof is desired the eighteen year period from 1915 to 1932 supplies it. Nevertheless, there were many persons who, like General Smuts, were impressed that the volume of business and demands for money and credit were growing faster than the money supply. The volume of production and trade, measured by statistics of money values, was growing very rapidly, mainly because prices were rising, which is only another way of saying that money was losing in purchasing power. The demand for money and credit was increasing because more of it was being required to handle the same physical volume of trade, and with rising prices more people were wanting to borrow for the purpose of buying something that they thought would go higher. The prosperity illusion was complete.

During this period, 1900-1913, and to some extent before, an important reorganization of industry was taking place in the United States, by the consolidation of industries previously owned by individuals, partnerships and local corporations into large corporations whose business covered the country, which were financed by issues of bonds and stocks that were listed on the New York Stock Exchange and sold to investors in all parts of this country and abroad. These securities, being assured of a large market, became good as collateral for loans, and inasmuch as they were subject to considerable price fluctuations they became popular as a means of speculation, thus greatly increasing the demand for bank credit. Credit created upon the basis of security loans became an important permanent factor in bank deposits, and increased the supply of purchasing power in circulation.

The Proof of Inflation

The average rise of commodity prices from 1899 to 1913 was approximately 33 per cent, which shows the fallacy of the Smuts theory. If human labor be accepted as the ultimate standard of value, and if prices were adjusted to correspond to the amount of labor embodied in products, the natural trend of prices would be downward, because improvements in industry are constantly reducing the labor content of production. When this natural trend is reversed, and the average price level rises, it is clear proof that the standard of value is depreciating. A person who loaned a sum of money in 1899, which was repaid in 1913, received back the same sum, but its purchasing power was 25 per cent less than when he loaned it. This was the reverse of the recent trend.

Besides the rise of commodity prices in the 1900-1913 period, there was a general rise of property values, notably real estate values, and all business was under the stimulus which rising prices always give. The average selling price per acre of all the farming lands in the United States doubled from 1900 to 1910, and then doubled again to 1920. The expectation that land values would continue to rise became an apparently permanent factor in land values. Lands sold upon a very low income basis, because an increment of selling value was expected.

No Increment of Real Wealth

Rising prices are always welcomed as signifying good times, and this view is justified when they represent a recovery from a state of abnormal depression, but there is no increment of real wealth from a mere rise of prices. In the case of land, no increase of productivity results from it, and although a farm may sell for more money than the owner paid for it, all money values are relative and if the general level of prices has risen, the farm is convertible into no more of other wealth than before the rise occurred. Nothing has changed but the measuring stick, and the situation is full of illusions.

The extreme prices for farms in the middle West never were justified by the annual returns, and were harmful in several ways. They stimulated an expansion of farm acreage over lands of uncertain productivity, which proved to be unprofitable and injurious to established agriculture. The greatest harm, however, was done by the increase in the volume of farm indebtedness.

Influence of Inflation Upon Indebtedness

A rising trend of prices long continued invariably has very undesirable consequences. The most serious of these is the increase of indebtedness. A standing inducement is held out to everybody to go into debt as deeply as possible, spreading his own capital thinly over all the property he may be able to bargain for on the basis of future payments. The game of money-making as thus practiced has been found to be a most enticing one. So long as the rising price movement continues the player wins, and the policy supports the upward movement; moreover, the longer the rise continues, the more confidence is displayed and the narrower the margins become. Also, the buyer reckons his wealth as steadily increasing, thinks he is rich, and loosens up in his expenditures accordingly. This for a time seems to be good for business, but when the whole community is involved it is living on unrealized expectations. The luxury industries and services expand, the body of unproductive investments grows, fixed charges of every kind, public and private, increase, and the situation becomes inherently weaker.

Always, after such a situation has collapsed, there are people who contend that the "prosperity" might have continued without end if only more money and credit had been provided, but the whole situation is based upon the illusion of inflated prices. The real wealth of the world grows only by the increase of values based upon utility, and these are not increasing to correspond with the increase of debt and expenditures. Indebtedness becomes the senior partner in business, taking an increasing share of the earnings, and interest charges, waste and extravagance eventually become insupportable.

The War Inflation

Upon the pre-war situation as developed by the 1900-1913 inflation, was imposed the war and post-war structure of inflation. The gold reserves of $1,290,000,000 in 1913 were increased to about $4,500,000,000 in 1924, and later reached about $5,000,000,000, but, it should be said, never were used to their full credit-making capacity. However, our banking resources (and liabilities) expanded to about $72,000,000,000 from $25,000,000,000 in 1913. Individual bank deposits which were $7,238,900,000 in 1900 and $17,475,800,000 in 1913, expanded to $53,157,900,000 in 1929. This increase did not signify savings, but deposits created by loans and based upon increasing gold reserves. There was no such increase in actual wealth.

This inflation of purchasing power subject to check affected not only property valuations but the entire structure of prices, including the rates of personal compensation. Of course, wages and salaries had to rise to enable the recipients to even maintain the former standard of living. The costs of government rose, not only because wages and salaries were higher and public indebtedness had increased enormously, but because the mania for larger expenditures raged there as elsewhere. The cost of living, of course, tended to rise with the wages and prices which compose it, but modified by the influence of improvements in production, the one constant factor which amid all the illusions has been producing real economic gains.

Other Influences for Inflation

To the influence of gold inflation in the increase of indebtedness was added the influences of war and paper money inflation abroad. The concentrated demands of the world upon the industrial capacities of the United States exerted a great influence for rising prices, our own participation in the war was another, and the heavy trade balances in favor of this country, together with the fact that this was practically the only country remaining on the gold basis, caused gold to come here in quantities which made credit inflation inevitable. It permeated every part of the country, and affected every kind of property and every kind of a price. Rising prices aroused the speculative impulse everywhere, started the farm land boom in the middle West, the Florida boom, the real estate boom in cities and suburbs, and, finally, all sections of the population being inocculated with the virus, the stock market boom gave the finishing performance.

It always has been one of the curiosities of discussion over monetary crises that so many people regard a growth of indebtedness as proof of a scarcity of money. Some persons gravely insist that there should be money enough to do all business without using credit. The period 1900-1929 shows that rapidly increasing supplies of money and rising prices invariably induce debt-making on a great scale. It is an illuminating truth that people go into debt in booming times, and liquidate indebtedness, in fear and under pressure, in bad times. They make the conditions themselves by mass movements first in one direction, then in the other.

The Utility of Credit

The indebtedness of the world has become enormous and undoubtedly presents one of the chief problems of the time, although it is important that no hasty conclusions be drawn about it. In the main the debts are the result of war and monetary inflation, together with the illusions and over-confidence inspired by inflation. What may be said on the side of abundant supplies of money and credit and the rising prices which result from them?

It is argued that rising prices stimulate production and enterprise, increase the demand for labor, lighten the burden of debt and create general prosperity. There is truth in these claims, but there is more to the account. The record of the period 1900-1913 shows that the rising prices of that time were accompanied by great irregularity in business conditions, also that labor experienced constant difficulty in getting wages increased fast enough to cover the rising costs of living, and that because it seemed to be easy to pay debts in a depreciating currency, few people cared to pay or reduce debts, and the aggregate amount of indebtedness increased rapidly. The logical conclusion seems to be that an artificial stimulus persistently continued does not produce beneficial effects. Industry and trade do not need an artificial stimulus. The ever-growing wants of the people afford all of the stimulus they require, and they are best served by stable conditions. Price changes, up or down, are a disturbing influence.

Credit is a useful factor in business affairs, for the flexibility which it affords in the employment of capital. Many persons come into the possession of capital by inheritance or by saving who for various reasons do not wish to engage actively in business. Women often are so situated, and men in the later years of life, wishing to retire from activity. Many people by taste are disinclined to business pursuits. Such persons prefer to lend their capital for a fixed return, but there are others so circumstanced that they can employ more capital than they own and who desire to extend their operations by borrowing. These parties together are in position to do business that is mutually advantageous and also beneficial to the public, because it promotes the serviceable employment of wealth.

While it is true that rising prices and an ample basis for credit give a stimulus to enterprise, it may be an unneeded and unhealthful stimulus. The business world cannot produce wealth any faster than when its productive capacities are fully employed and all branches of industry are in balanced relations. When this is the situation an attempt to drive the organization harder by the stimulus of more credit simply results in a competitive struggle for labor and supplies that drives up wages and prices. It does not increase production. It stimulates speculation and adventure rather than sound business. Beyond the use of credit to facilitate the full employment of capital and labor, credit expansion becomes an influence upon prices, and, except as used to stabilize prices, an undesirable influence. Stability is the all-important requirement as to the credit supply.

Settling for the Evils of Inflation

In this period of reaction and depression, the world has been settling for the excesses of the inflation indulged in throughout the entire time from 1900 to 1929. From the day when inflation had exhausted itself, and the expectation of higher prices began to wane, the overhanging body of indebtedness became a subject of apprehension, and has accounted for the heavy liquidation of property of all kinds. The offerings have been too large to be readily absorbed, hence the disastrous loss of values. In ordinary times the number of farms offered for sale was no greater than would be readily taken by purchasers, or if a purchaser did not appear promptly a moderate concession from the ruling price would induce somebody to buy it, not because he intended to keep it, but because of confidence that he could sell it at a profit. The latter case is an example of useful speculation, which tends to stabilize prices. In most localities the trend of farm values in the years down to 1920 was upward and as a mortgage matured it was more often increased than paid off. This was particularly true of the best farming states. The Department of Economics of the Iowa State College of Agriculture recently has given out a statement showing that the farm mortgage debt of Iowa is now three times what it was in 1910. The increase is the net result of the war "prosperity." With the fall of farm products the pressure of debt began to force farms on the market in numbers that affected prices. Lenders began to condition renewals upon reductions of principal, and some of them retired from the farm mortgage field. As the decline of values pro-

ceeded, and one layer after another of equities was wiped out, confidence was shaken, sales were hard to make, and there was increased insistence upon debt reductions. The speculative buyer disappeared. This description applies to other property as well as to farms. The decline of values has been unprecedented because the inflation had been unprecedented, the body of indebtedness was unprecedented and the market, previously overweighted on the buying side became heavily overweighted on the selling side.

Furthermore, no such destruction of values could occur without affecting the banks, and the closing of thousands of banks and general shrinkage of deposits resulted in a general contraction of bank loans, which aggravated the state of stringency and alarm, and made the conversion of property into cash still more difficult. Nothing else has such panic-breeding effects as a disturbance of bank credit, always excepting a threat against the monetary standard, and there have been fears, rumors, and agitation upon that account also in the past year.

Finally, the disastrous decline of business activity, falling prices and loss of earnings, depressed all values. The capacity of any kind of property or business to carry indebtedness depends upon its assured, low-water, earning power, which is the test of "value based upon utility." Evidently there had been a tremendous over-estimate of utility values since 1900.

The Pressure of Debt

It would not have been so bad if the over-estimate had been represented by ownership instead of debt. Even with high prices, if people bought only what they could pay for, no crisis could occur. Whether in the stock market, the real estate market or the commodity markets, it is the menace to equities—margins — which forces liquidation, breaks down values, undermines confidence, shrinks credit, closes banks, and creates the general state of panic that unsettles everything.

The division of interest between debtor and creditor becomes a social problem in times like these. It is unmistakably safer to own a 160-acre farm clear of debt than a 320-acre farm mortgaged at one-half its boom-time appraisal, and this has been demonstrated many times in the past. The evil is in the possible conflict of interests in the same property, and the gravity of the present situation is in the unprecedented number of equities in danger of being wiped out.

A Temporary Situation

The disastrous shrinkage in nominal values of all kinds of property does not signify a deliberate reappraisal of values. It is due to the conditions which have forced an extraordinary volume of offerings upon the markets and at the same time frightened away purchasers. In other words, it is only an unusual demonstration of the workings of the law of supply and demand, frequently seen in the commodity markets, but in this instance seen in the real estate and security markets. The low prices will pass when the normal equilibrium between offerings and demand is restored.

Not Due to Scarcity of Gold

The situation is not due to any change in the country's monetary system. The most recent act in which the United States dollar is defined is that of 1900, and no change was made in it then. It is not due to an inadequate supply of gold in our monetary system. The physical volume of production and trade increases in this country at the rate of 3 or 4 per cent annually, and a corresponding increase in the gold reserves would be more than ample to sustain the price-level, for the efficiency of the banking system is constantly increasing and has been much increased since 1913 by the development of the Federal Reserve system. Inasmuch as our gold reserves have been approximately trebled since 1913, there should be no question as to their adequacy now or in the intervening years. The banking system of this country is capable of supplying more money or credit than has been used at any time in the past.

Nor is there reason to believe that the supply of gold is inadequate to support a general revival of business over the world. The exportation of over $1,000,000,000 from this country in the last twelve months has changed the situation in Europe materially. The table shows the bank holdings down to a recent date.

It is true that gold suddenly has seemed to be much more valuable in comparison with all other commodities than it was during the war and down to 1929, but an analysis of the situation does not support the idea that the change was on the side of gold. Rather is it true that the change was in the state of mind, which suddenly prompted the public to distrust all forms of credit, all values except money values, and act in a mad panic to convert everything into money and finally into gold? Already in the last six weeks a pronounced lessening of the panic has occurred, and, to adopt the point of view that has been so generally in favor, gold has fallen in value to a notable extent. When the billion dollars or more of currency that was taken from the banks by timid depositors for hoarding is returned to the banks the situation will be further improved. If when

credit conditions and the state of the public mind are restored to normal the price level proves to be about what it was before the war, will the fluctuations of the intervening time have been due to an inherent instability of gold or to instability elsewhere?

Causes of the Depression

There are two primary causes of the disordered state of industry and business depression, (1) the great increase of gold production since 1900, which has been largely responsible for the growth of indebtedness, and (2) the War, with its disturbance of normal industry and trade, including the violent disruption of wage and price relations. We discussed the latter at length last month.

The disturbance directly and indirectly chargeable to the War has been enormous, not only in this country but all over the world.

As alarm has spread with the progress of liquidation in the last three years, an almost unbelievable shrinkage of both capital expenditures and personal expenditures has taken place throughout this country, causing a loss of employment which of itself has resulted in an enormous loss of buying power. The luxury trades and services have been curtailed even more rapidly than they were expanded when the debt-making mania raged. Although the basic cause has been economic disorder, the psychological factor has been very influential both in the period of expansion and the period of contraction. The restoration of balanced relations, with the increase of employment and consumption which will surely result, will inevitably lift the price level.

The causes of the depression are graphically summed up by an Englishman whose opinions upon finance carry weight, Mr. F. H. Hamilton, in the London "Statist" of July 9, 1932, in an article from which the following is an extract:

The Gold Standard is not infallible, no conceivable system is. So far from being foolproof, it is an exceedingly complex and delicate instrument requiring skilled, experienced and honest control in order to ensure its relatively smooth working. Other conditions also are necessary, including a reasonable correspondence between wages and commodity prices, a reasonable readiness to accept payment of international debts in the form of goods, and a reasonable degree of international goodwill, but it is only on these terms that international trade and investment can continue at all. When, therefore, it is alleged that the Gold Standard has broken down, it is well to remember that none of the necessary conditions have been satisfied, and that given the facts as they exist, no system other than barter, and that only on an insignificant scale, could have survived the series of economic earthquakes to which the world has been subjected.

During and since the war we have witnessed the transfer of nominal, and to a large extent of actual, wealth on a scale unprecedented in history. Creditor nations became debtors and debtors creditors; the hegemony of world commerce and business passed, or seemed to pass, across the Atlantic almost over night. Every belligerent nation, with the exception of the United States, inflated its currency at one time or another. The war treaties in the sacred cause of self-determination created some 14,000 miles of fresh frontiers in Europe, along which the newly liberated nations erected tariff walls of almost unscalable height, while the United States, not to be outdone, insisted on the payment of war debts, in order to discourage European armaments, and raised its already towering import duties, in order to encourage American manufacturers, with the ridiculous result that a creditor nation deliberately made it impossible to receive payment of its debts in any effective form. Meanwhile the secular enmity between France and Germany continued, and still continues in a subacute form, to poison international relationships, and sterilise every effort towards peace and goodwill. Now all this has nothing to do with gold, and to attribute the upheaval and dislocation from which we are suffering to the failure of the Gold Standard to function is simply to misuse language. The Gold Standard did not fail, it was overwhelmed over a large area by the impact of forces which would have pulverised and destroyed any conceivable system of international trade or basis of credit.

The Question of Silver

Not infrequently comment is made to the effect that the present situation has vindicated the campaign of 1896 to re-establish silver as basic money along with gold. Without entering into the conditions upon which the remonetization of silver was then proposed, it should be said that if the double standard had been successfully re-established as proposed and the basis for credit thereby broadened, the monetary inflation since 1900 must have been much greater than with gold alone as the basis, and the increase of indebtedness presumably would have been correspondingly greater, assuming that bi-metalism was maintained to the present time.

There has been no need to broaden the base for credit, by the use of any money but gold at any time from 1896 to the present. It shows an entire misconception of the situation to say so, in view of the rise of gold stocks shown by the above table. Talk that the addition of silver to the monetary base would have afforded a broader and safer basis for credit assumes that the addition of silver would not of itself have caused a further expansion of credit. Of course if bi-metalism had been successfully established, increasing supplies of silver would have had the same effect upon credit expansion that increasing supplies of gold have had. Inflation would have proceeded at a higher rate until the credit structure became top heavy and then crashed as it has done. Only by requiring the maintenance of larger banking reserves could this outcome have been avoided. The view has been advanced and received the approval of some orthodox economists that some kind of government control over gold production should have been established during the period of rapidly increasing supplies, but that would not have been easily accomplished. An increase of reserve requirements would mean a restriction of credit, but the popular demand always is for more money and more credit. This is illus-

trated by the idea of having so much money that nobody would need to buy anything on credit, which is equivalent to saying that everybody should have everything he wants without having to wait for it even until tomorrow.

Proposals for a Managed Currency

Somebody may be prompted to ask if the experience with gold inflation as related above, together with the warnings now heard that gold production may decline, do not go to show that the supply of gold is too uncertain for that metal alone to serve acceptably as the standard of all values, and therefore afford support to the argument for a managed currency, regulated solely by the quantity, without redemption in anything. Of course, nobody claims that gold is a perfect standard of value. It came to be the standard of nearly all the world by a process of evolution, because it served better than any other commodity, and a common standard of value for all nations proved to be of enormous service in trade and all financial intercourse. Silver has ranked next in esteem for the same purpose, but gold has had the preference for international transactions, because, for one reason, of its higher value in proportion to weight, a factor of increasing importance as the wealth of the world and volume of international transactions increased. Both were used for a long time, but inasmuch as their values varied to each other continually it was found impracticable to permit the free coinage of both at the same time in the same country. Silver was better suited for money in the Far East, where values were relatively low, and gold for use in the countries where values were higher.

A Subject for International Treatment

In the great political campaign of 1896, when silver was the issue, the Democratic party, with Mr. Bryan as its candidate, advocated the immediate remonetization of silver, 16 ounces of silver to be the equivalent of 1 ounce of gold. The Republican party, with William McKinley as its candidate, took the position that the country had been on the gold basis throughout nearly all of its history, that almost all the nations with which we had important business relations were on the gold basis and that to change from that basis would seriously disrupt these relations. It proposed as an alternative policy that we endeavor to interest the other important nations in a plan to link gold and silver together in all monetary systems upon an agreed ratio. After the election of McKinley he appointed a Commission to negotiate for an international agreement as proposed, but the effort was unsuccessful, the nations of Europe being satisfied with the gold standard. Whatever may be best for the future that undoubtedly was a wise decision at the time, since gold alone provided an overdose of inflation in the following decade.

Apprehension that gold production may fall off, or fail to keep pace with monetary needs, is based upon the fact that the older mines of the South African field are nearing exhaustion. The field is still making a new record every year, but its long continuance will depend upon the utilization of low grade ores which at present cannot be profitably worked. These bodies are very large, and production costs are being steadily reduced. Moreover, the industry is bearing such a heavy burden of taxation that it is said to be within the power of the Government to extend the life of the field for many years by reducing its levies, and since it could derive no revenue from abandoned mines this relief is likely to be given. Finally, gold production is now increasing again in all countries where deposits exist. World production in 1932 will be but little if at all below the years immediately preceding the war, when the rate was higher than required to maintain a stable level of prices. On the whole there is no reason to anticipate a shortage of gold in the near future.

If the pessimistic predictions should be realized and gold production should decline, there would remain the possibility of reviving the project for establishing bi-metalism under an international agreement, or of developing the idea of a managed currency under the auspices of an international organization with which the Central banks of all countries would be associated. In view of the known difficulties attending upon all attempts at international cooperation, the last seems to be rather a chimerical proposal, but theoretically it appears to be not impossible. It requires international cooperation, but return to the gold standard, establishment of bi-metalism, or any other treatment of the subject, requires international cooperation. The fact is that modern civilization requires international cooperation, and when the world once grasps this fundamental truth, and forms the habit of cooperating, all of these problems will be rapidly simplified.